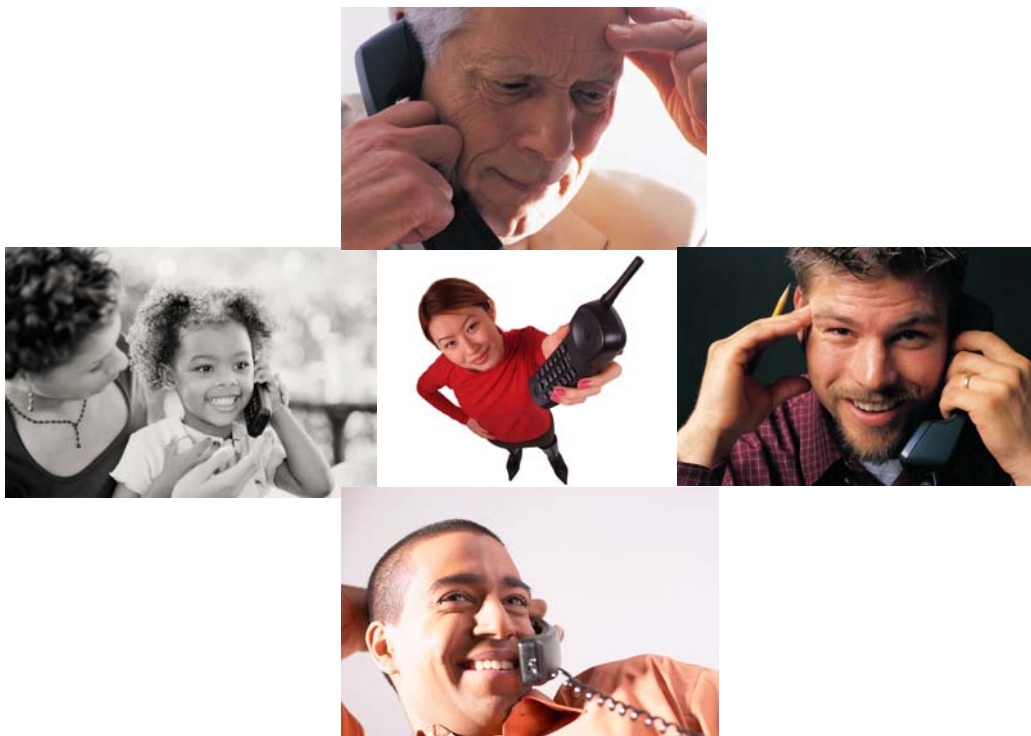


California Public Utilities Commission



Report to the California Legislature

Universal Telephone Service to Residential Customers



In Accordance with California Public Utilities Code Section 873

Respectfully submitted

June 2006



I. INTRODUCTION

A. PURPOSE OF REPORT

The California Public Utilities Commission (CPUC) has prepared this report for the California Legislature regarding universal telephone service to residential customers in response to Public Utilities Code Section 873. This report, which was prepared by the CPUC's Telecommunication Division (TD) staff, assesses the degree of achievement of universal service, including telephone penetration rates by income, ethnicity, and geography pursuant to the requirements in this statute.

B. UNIVERSAL TELEPHONE SERVICE: CALIFORNIA LIFELINE

As discussed in Public Utilities Code Section 871.5, universal telephone service is a concept that high quality basic telephone service be affordable and ubiquitously available to all members of society. It is a longstanding cornerstone of the California Legislature and the California Public Utilities Commission telecommunications policy. In response to this policy commitment and in compliance with this statute, the CPUC in 1985 created the Universal Lifeline Telephone Service (ULTS), or California Lifeline, Program.

The California Lifeline Program provides discounted basic residential telephone services to low-income households and operates a competitively neutral marketing program. For eligibility purposes, low-income households are defined as the members of the customer's household collectively earning no more than the following amount of annual income:

Household Size	ULTS Annual Income Limits (6/1/06 through 5/31/07)
1-2 members	\$21,300
3 members	\$25,100
4 members	\$30,200
Each additional member	\$5,100



Discounted residential telephone services available to California Lifeline customers include but are not limited to the following:

Service	Description	Rate
Flat-Rate Local Telephone Service	Unlimited local calls and same free access to directory assistance calls as provided to non-ULTS flat-rate residential customers.	Monthly recurring: the lower of \$5.34 or 1/2 of utility's residential flat-rate local telephone service.
Measured Local Telephone Service	60 local calls per month and \$0.08 per call after 60, and same free access to directory assistance calls as provided to non-ULTS measured-rate residential customers.	Monthly recurring: the lower of \$2.85 or 1/2 of utility's residential measured local telephone service.
Service Connection and Service Conversion	For initiation of telephone service, or change of class/type/grade of service.	Non-recurring: the lower of \$10 or 1/2 of utility's connection/conversion charge for residential telephone service.

The California Lifeline Program is funded by an all-end-user surcharge assessed on consumers' bills for intrastate telecommunications services. For the calendar year 2004, the collected surcharge revenues totaled approximately \$220 million. The number of residential customers participating in the program grew marginally over 2003 to 3.45 million in 2004, and to an estimated 3.46 million in 2005. In both 2004 and 2005, thirty-three carriers provided Lifeline service to California customers.



II. TELEPHONE SUBSCRIBERSHIP IN CALIFORNIA

A. CALIFORNIA'S TELEPHONE PENETRATION RATE - SIXTH IN THE NATION

The most widely used measure of telephone subscribership is the percentage of households with telephone service, which provides a measure of telephone usage or penetration. The Federal Communications Commission (FCC), using data from the Current Population Survey (CPS) conducted by the Census Bureau, has maintained quarterly data on subscribership rates since 1983. FCC data is useful as it can be used to compare penetration rates over time, judge the effectiveness of our Lifeline Program, and determine how California is progressing relative to other states. This report utilizes the most current, year-end data publicly available from the FCC, which does not yet include 2005 figures.

For 2004, the telephone subscribership penetration rate for all households in the United States was 94.0%, a slight decrease from 95.1% in 2003.¹ By state, the penetration rates ranged from a low of 88.6% in Arkansas to a high of 97.1% in Minnesota. Among all states, California ranked sixth overall with a penetration rate of 96.0%. In comparison with the prior year, the 96.0% rate is a slight decrease from California's previous penetration rate of 96.5% in 2003.² Table 1 lists the top fifteen states with the highest penetration rates, as well as the financial support each state provides per line. Within those top fifteen states California is near the middle, providing the seventh highest amount of funding (\$2.48 per line).

¹ Source: FCC, *Telephone Subscribership in the United States* (November 2005)

² Source: CPUC, *Report to the Legislature on Universal Telephone Service to Residential Customers* (July 2004)



Table 1

Top Fifteen States with Highest Penetration Rates for 2004³

STATE	PENETRATION RATE FOR ALL HOUSEHOLDS	AVG STATE SUPPORT PER LINE
1. Minnesota	97.1%	\$1.57
2. Maine	96.6%	\$3.50
3. Massachusetts	96.4%	\$8.45
4. New Hampshire	96.4%	\$0.00
5. Utah	96.3%	\$3.50
6. California	96.0%	\$2.48
7. Delaware	96.0%	\$2.30
8. Vermont	95.9%	\$3.50
9. Nebraska	95.7%	\$3.48
10. Alaska	95.6%	\$3.50
11. Pennsylvania	95.6%	\$1.03
12. Connecticut	95.5%	\$1.18
13. Washington	95.5%	\$1.90
14. Wisconsin	95.5%	\$1.23
15. Hawaii	95.4%	\$0.00

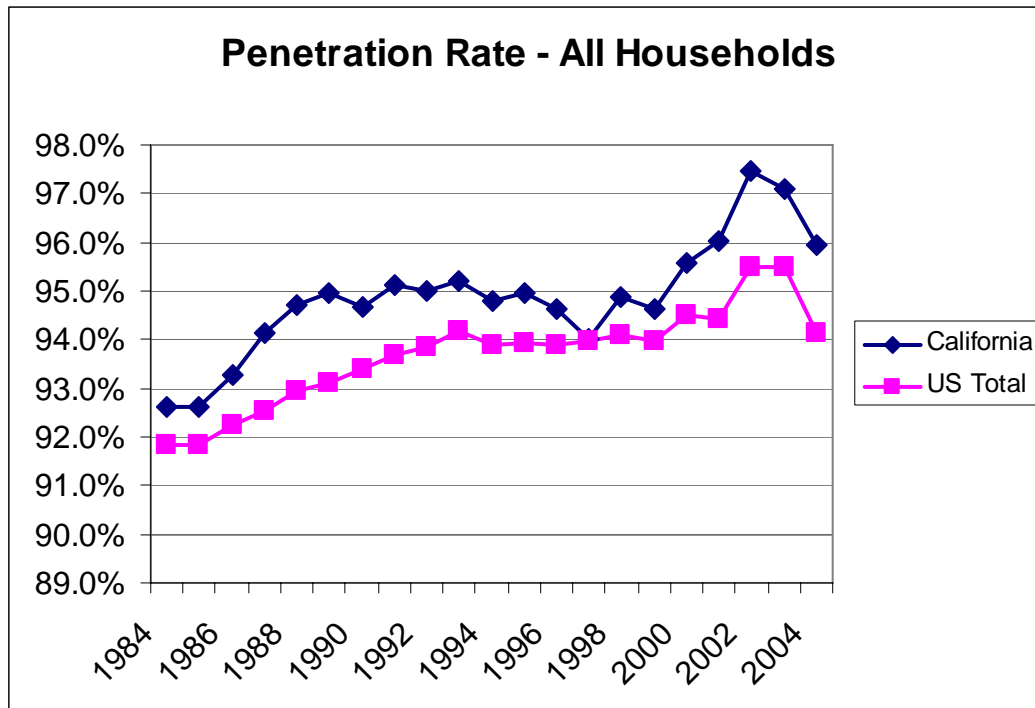
³ Source: FCC, *Telephone Subscribership in the United States* (March 2005)



B. PENETRATION RATES FOR LOW-INCOME HOUSEHOLDS HIGHER SINCE LIFELINE ASSISTANCE PROGRAM INTRODUCED

As Chart 1 illustrates, California's telephone penetration rate for all households has increased since the inception of our Lifeline Program. Although California leads national figures by approximately 1-2% each year since 1984, the penetration growth rate trends are similar for both California and the nation.

Chart 1



Source: FCC, *Telephone Penetration by Income by State*, March 2005

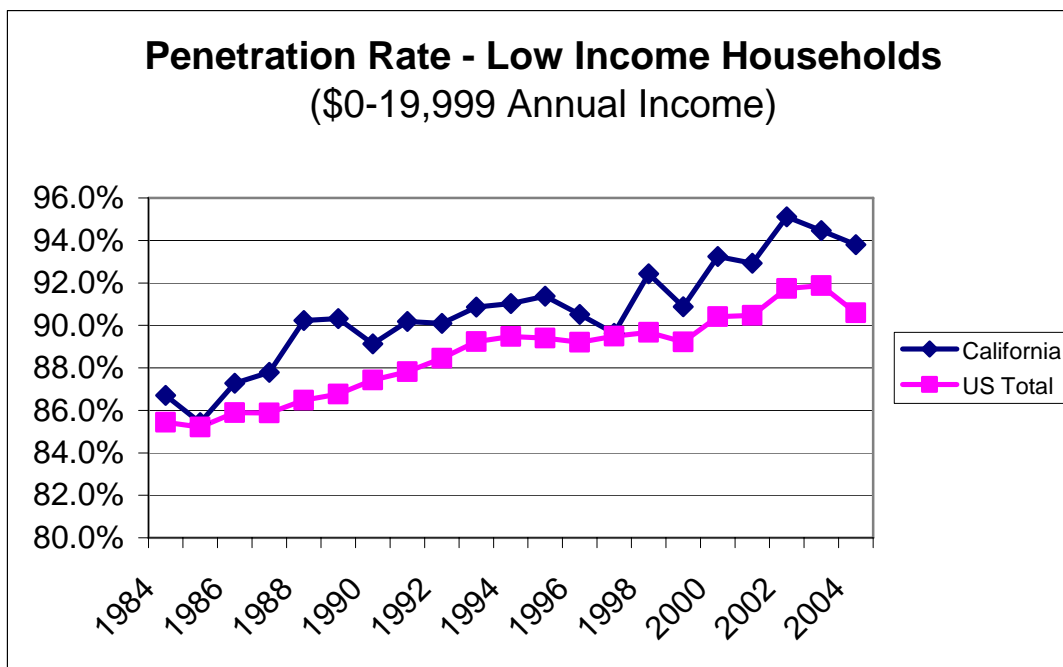
As can be seen in Chart 2, prior to the implementation of lifeline assistance in 1984, California's penetration rate for *Low-Income Households* was 82.9%. After implementation of the program, the penetration rate for low-income households grew to 87.7% by March 1994 and as of March 2004 reached 92.5% (versus 90.6% for all low-income households nationwide).⁴ While

⁴ FCC, *Telephone Penetration by Income by State*, March 2005



there is still a disparity between low-income households and all households, the gap is lessening.

Chart 2



* Low Income data consists of an average of \$0-9,999 households and \$10,000-19,999 households

Source: FCC, *Telephone Penetration by Income by State*, March 2005

III. TELEPHONE PENETRATION DATA BY INCOME, ETHNICITY, AND GEOGRAPHY

A. ILECS' OVERALL PENETRATION RATES

As of December 31, 2004, the twenty-two incumbent local exchange carriers (ILECs)⁵ provided 83% of the access lines⁶ to California wireline residential customers.⁷ Competitive local exchange carriers held the remaining 17% of the

⁵ Incumbent Local Exchange Carrier. The traditional wireline telephone service providers within defined geographical areas. Prior to 1996, ILECs operated as monopolies having the exclusive right and responsibility for providing local and local toll telephone service within LATAs. ILECs include regional Bell operating companies such as Pacific Bell/SBC and non-Bell affiliated companies such as Surewest Telephone Company, both in California.

⁶ An access line is a telephone line reaching from the telephone company central office to a customer's premises, which in this case is a residential dwelling unit.

⁷ FCC: *Local Telephone Competition: Status as of December 31, 2004*, Table 6



residential wireline market.

Since ILEC's hold the lion's share of access lines, the CPUC's TD staff sent data requests to the twenty-two ILECs in February 2005 seeking specific information regarding telephone penetration rates for their service territories, including penetration rates by income, ethnicity, and geography. Eighteen ILECs responded to the data request. SBC California⁸ and Verizon California, the two largest ILECs in the state, were able to provide significant data as a result of carrier-specific CPUC requirements since 1994 (per Decision 94-09-065). The remaining sixteen carriers reported that they do not track customer information by income, ethnicity, and geography.

SBC's California penetration rate was 95.9% for 2004. For Verizon California, the overall penetration rate was 97.2%. Using a weighted average, the state's two largest ILECs have a 96.1% overall penetration rate, which is slightly above the state average of 96.0% for that year.⁹

Tables 2, 3, and 4 below show the carriers' estimated penetration rates assessed by Household Income Level, Ethnicity/Race, and Geographical Area.

⁸ The CPUC approved the merger of SBC and AT&T in December 2005. Since this report relates to SBC California data prior to the merger, the report refers to the carrier as "SBC", rather than the company's new name, AT&T.

⁹ Carriers' data is derived from the Census Population Survey (CPS) and includes a sampling error of plus or minus 3% each month. Subcategories of data may have different margins of error, depending on their sample sizes: smaller samples involve potentially higher margins of error. Although CPS does face some refusals when conducting the survey, replacement households are chosen based on similar location and characteristics.



B. HOUSEHOLD INCOME LEVELS INFLUENCE PENETRATION RATES

Table 2

Penetration Rates of SBC and Verizon by Household Income Level

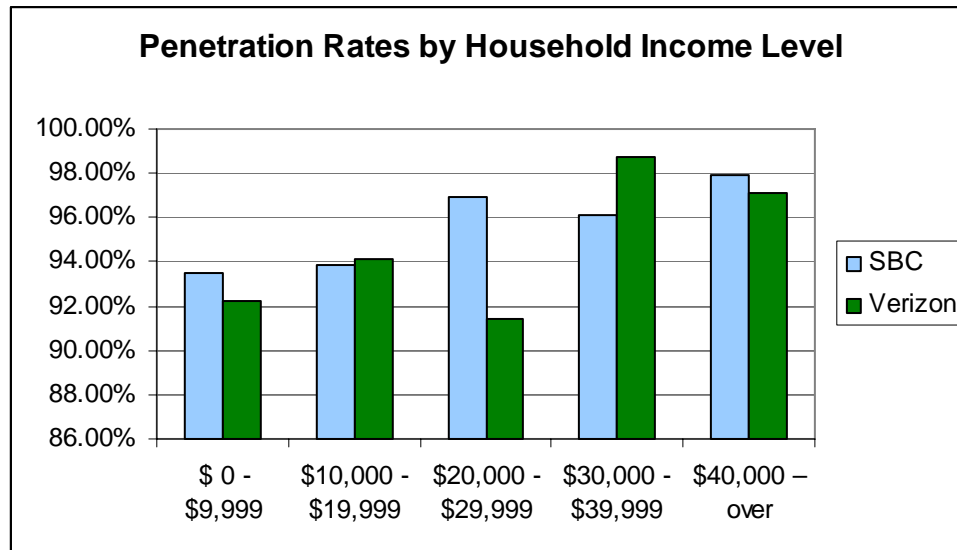
HOUSEHOLD INCOME LEVEL	SBC PENETRATION RATE	VERIZON PENETRATION RATE¹⁰
\$ 0 - \$9,999	93.5%	92.2%
\$10,000 - \$19,999	93.9%	94.1%
\$20,000 - \$29,999	96.9%	91.4%
\$30,000 - \$39,999	96.1%	98.7%
\$40,000 – over	97.9%	97.1%

In reviewing Table 2, it is clear that for both SBC and Verizon, household income levels directly affect telephone subscriber penetration rates. Rates for the two lowest income categories are similar for both carriers and remain below the 96.0% state average. However, household income ranges over \$30,000 exceed the statewide average for both ILECs, as higher incomes generally translate into higher penetration rates for service. Overall, a 5% to 6% difference exists between the lowest and highest income levels for both SBC California and Verizon.

¹⁰ Verizon penetration rates reflect 2005 data, whereas SBC's penetration rates reflect 2004 results.



Chart 3



C. DIFFERENCES IN PENETRATION RATES BY ETHNICITY/RACE

In reviewing Table 3 below, it is evident that telephone penetration rates can vary by a 2 to 4% percentage point gap across ethnic groups in the two dominant ILECs' territories. For SBC, the reported penetration rate for African-Americans and Hispanics were 94.2% and 94.8%, respectively. However, SBC reported that Asian Americans and White/Other were at or above 96%. For Verizon, the difference among ethnic groups was a bit larger. Whereas Verizon reported a 93.1% penetration rate for Hispanics, and roughly 95% for both Asian-Americans and African-Americans, the penetration rate for White/Other was as high as 97.3%.

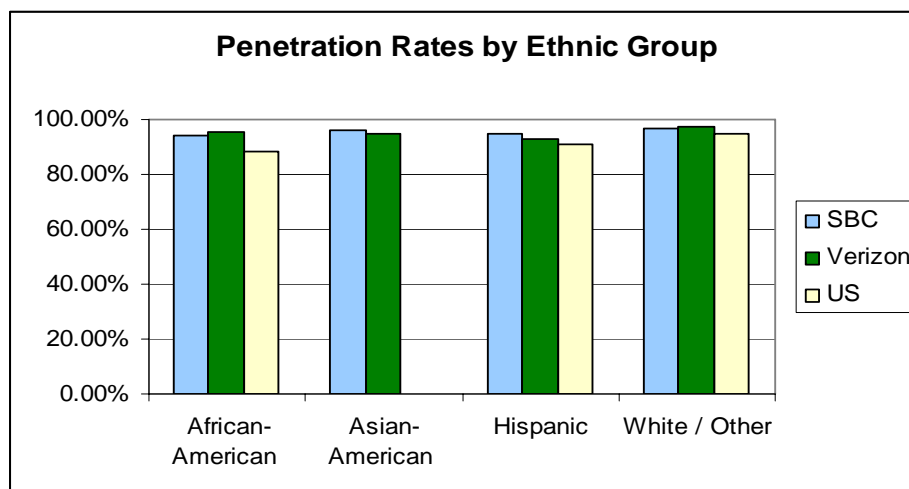


Table 3
Penetration Rates of SBC and Verizon by Ethnicity/Race

ETHNICITY/RACE	SBC PENETRATION RATE	VERIZON PENETRATION RATE ¹¹	US PENETRATION RATE
African-American	94.2%	95.3%	88.6%
Asian-American	95.9%	95.0%	NA
Hispanic	94.8%	93.1%	90.9%
White / Other	96.6%	97.3%	94.6%

A review of Table 3 also reveals that California's penetration rates as compiled by SBC and Verizon compare quite favorably with the FCC's nationwide penetration rates, particularly among African-American and Hispanic households. Nationally, households headed by African-Americans had an average rate of 88.6% and those headed by Hispanics had a rate of 90.9%.¹² For Whites/Other, the nationwide average rate was 94.6%. Conversely, California's results from SBC and Verizon data exhibit significantly higher rates than the nationwide averages for each of these categories. The FCC does not track demographic information about Asian Americans.

Chart 4



¹¹ Verizon penetration rates reflect 2005 data.



D. DIFFERENCES IN PENETRATION RATES BY GEOGRAPHIC AREA

Table 4

Penetration Rates of SBC and Verizon by Geographical Area¹³

GEOGRAPHICAL AREA	SBC PENETRATION RATE	VERIZON PENETRATION RATE ¹⁴
Northern California ¹⁵	96.3%	95.4%
Southern Central Valley, Central Coast, and Rural Areas ^{16 17}	95.1%	94.8%
Southern California	96.1%	96.2%
Greater San Francisco Bay Area ^{18, 19}	95.8%	95.7%
Greater San Diego Area ²⁰	96.5%	N/A

Table 4 shows slight variances in penetration rates by geographic areas, but does not suggest major geographic disparities among different regions throughout the state. For both carriers, all geographic areas show a penetration rate near or above 95%.

IV. IMPROVED LIFELINE TELEPHONE SERVICE

During the 2004-2005 fiscal year, the California Public Utilities Commission worked with Richard Heath & Associates (RHA) to develop methods to better

¹² FCC, *Telephone Subscribership in the United States*, November 2005, Table 5

¹³ Geographic penetration data was derived from the February 2005 data request sent to carriers by the CPUC.

¹⁴ Verizon's penetration rates reflect 2005 data.

¹⁵ For SBC, Northern California is defined as Butte, El Dorado, Placer, Sacramento, San Joaquin, Stanislaus, Sutter, Yolo, and Yuba Counties.

¹⁶ For SBC, this category represents Fresno, Kern, Monterey, and Tulare Counties, plus a selected sample from all other rural counties.

¹⁷ For Verizon, the Central Valley consists primarily of Bakersfield and communities along the Eastern Sierras.

¹⁸ In the Bay Area, Verizon's service territory includes the Novato and Los Gatos areas.

¹⁹ For SBC, this includes San Francisco, Marin, San Mateo, Santa Clara, Santa Cruz, Alameda, Contra Costa, Napa, Sonoma, and Solano Counties.



reach the Universal Lifeline Telephone Service target populations. Outreach measures included creating a new, clearer California Lifeline logo and catchphrase ("Connect...and save"), a media campaign promoted in nine different languages, and utilization of various community organizations (adult education centers, senior groups, small businesses) to distribute Lifeline materials.

By the end of fiscal year 2004-2005, California Lifeline Call Center results indicated that over 21,000 people transferred to Lifeline service, exceeding RHA's goal of referring a minimum of 18,000 income-eligible residents. This represents a significant increase from the 14,779 referrals from Sept. 8, 2003 to August 6, 2004. Additionally, 65% of the transfers in 2004-2005 were users who previously did not have telephone service. Media advertisements and community-based outreach were responsible for roughly 84% of the new Lifeline transfers, demonstrating the effectiveness of the Lifeline promotion programs.

V. FEDERAL SUPPORT AND CHANGES TO LIFELINE SERVICE

California LifeLine receives support from both state and federal funding. For 2004, federal LifeLine/Link-Up support provided \$301.72 million, California Lifeline support provided \$240.96 million, totaling \$542.68 million. However, in April 2004, the FCC issued an order (FCC No. 04-87) requiring that states document customers' income qualifications in order to continue to receive subsidies from the federal income-based Lifeline Link-Up programs. To preserve the \$300 million in federal Lifeline/Link-up support that California receives, California Lifeline will transition from the existing income-based self-certification to a program-based and income-documented system. Solix, Inc. will act as the Certifying Agent, and will maintain a database for the 3.4 million California Lifeline customers' information, qualify the eligibility of new and existing

²⁰ San Diego County.



customers, and implement an online system to help resolve consumers' complaints. The program changeover will occur on July 1, 2006.

Also starting July 1, 2006, customers may qualify for California LifeLine under either program-based or income-based criteria. The following public-assistance programs allow for eligibility in California LifeLine:

- Bureau of Indian Affairs General Assistance
- Federal Public Housing Assistance or Section 8
- Food Stamps
- Head Start Income Eligible (Tribal Only)
- Healthy Families Category A
- Low Income Home Energy Assistance Program (LIHEAP)
- Medicaid/Medi-Cal
- National School Lunch's FREE Lunch Program (NSL)
- Supplemental Security Income (SSI)
- Temporary Assistance for Needy Families (TANF)
- Tribal TANF
- Women, Infant and Children (WIC)

New program-based customers may enroll in LifeLine through self-certification, while new income-based customers will be required to provide documentation demonstrating that household income is at, or below, the aforementioned income guidelines.

VI. CONCLUSION

California continues to advance in its 1985 goals to promote universal telephone service and implement a Lifeline Program for its residents. California's current statewide penetration rate of 96.0% compares favorably to the national average



of 94.0%. Prior to the implementation of Lifeline assistance, California's penetration rate for *low-income households* stood at just 82.9%, and has improved to 93.8% in 2004. While the increase is impressive, California can continue to work to promote Lifeline telephone service. Low-income households (earning less than \$20,000 annually) in the state are still below the overall statewide average. In addition, for both of the two largest ILECs, African American and Hispanic households' telephone penetration rates are below statewide averages.

In future years, penetrations rates, such as those used in this report, may take on less and less meaning. Consumers are turning to non-traditional alternatives, such as wireless carriers, cable television companies, and Voice Over Internet Protocol (VOIP) providers for their telecommunications needs. Studies have indicated that in 2005 as many as 8% of US households that subscribe to wireless service have discontinued use of their land-lines (traditional telephone voice service).²¹

The Commission plans to continue its efforts in 2006 to promote awareness of Lifeline telephone service and to help provide California consumers with greater universal telephone access across the state.

²¹ Li Yuan. "More U.S. Households Are Ditching Landline Phones for Wireless." Wall Street Journal. March 31, 2006. Page A12.



REFERENCES USED IN REPORT PREPARATION

References used to compile this information include the following sources:

- *Telephone Subscribership in the United States* by Alexander Belinfante, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission. November 2005
- *Telephone Penetration by Income By State*, by Alexander Belinfante, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission. March 2005
- *Trends in Telephone Service*, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission. June 2005.
- Responses to "Data Request Regarding Universal Service in Your Service Territory" sent to 22 Telephone Carriers in California by the CPUC Telecommunications Division on February 17, 2005

Each of the above references addresses some aspect of telephone penetration information related to income, ethnicity, or geography. When viewed individually, they represent a patchwork of information but when viewed together, they form a telling picture of telephone subscribership in California and the nation.